

parable interest expense on deposits and other expenses are attributable to tax-exempt bond interest income, they are not deductible by a resident foreign banking corporation, although a domestic banking institution can claim such deductions.

In the light of the foregoing, we submit that to tax resident foreign banking corporations on their foreign source dividends, interest, and gains from the sale of securities does not achieve equitable tax treatment for their investments in the United States but serves to aggravate an inequity which exists under present law and would continue under the proposed legislation.

In addition, this novel concept of taxing foreign enterprises on their foreign source income is directly contrary to three-quarters of the Income Tax Treaties concluded by the United States with foreign countries which specifically limit U. S. taxation of foreign enterprises to their U.S. source income (e.g., Australia—Article III, Italy—Article III). The U. S. Treasury Department Regulations applicable to those few tax treaties whose provisions allow Federal taxation on all income allocable to a U. S. "permanent establishment," limit this rule to income from sources within the United States, thus evidencing the intent of even these treaties not to tax foreign source income (e.g., Canada—Regulation Section 519.104, France—Regulation Section 514.105). Since Section 10 of the Bill provides that no amendment by H.R. 13103 shall apply in any case where its application would be contrary to any treaty obligation of the United States, this motive to tax foreign source income would not apply to those countries with whom the United States has an income tax treaty limiting its taxing jurisdiction, thus discriminating severely against those nations with whom the United States has not yet concluded a treaty.

Furthermore, even though the United States may have an income tax treaty with the country of residence of a foreign banking corporation engaged in trade or business within the United States providing that only U. S. source income can be attributed to a permanent establishment in the United States (e.g. such as Article III of the 1946 United States-United Kingdom Income Tax Treaty in conjunction with Section 10 of H.R. 13103 allowing treaties to prevail; see also Houses Report No. 1450, page 121), a provision in the Internal Revenue Code which attempts to tax foreign source income of resident foreign banks in non-treaty countries could set the stage for future abrogation of the treaties presently in force.

United States taxation of foreign source interest income attributable to a U.S. place of business could result in multiple taxation under the Bill without a compensating offset for a foreign tax credit. Let us assume that the resident foreign bank is organized in country X and pays tax at an effective corporate rate of 60 per cent. Let us assume it earns interest income of \$500,000 in country Y which imposes a 15 per cent withholding tax thereon. The interest income is also attributable to the office in the United States and is taxed at 48 per cent. For purposes of simplification, we will assume that there are no deductible expenses and that the total taxable income subject to tax in country X is \$1,500,000 including the \$500,000 bond interest. We will also assume that country X has a per country limitation for foreign tax credits but no over-all limitation. In other words, the amount of any credit for foreign taxes paid or accrued to any foreign country is limited to the ratio of taxable income from sources within that country to entire taxable income applied to the tax due before credit in country X. The following calculation sets forth the taxes paid to the respective countries after the suitable credits:

	Country X	Country Y	United States
Taxable income.....	\$1, 500, 000	\$500, 000	\$500, 00
Tax computed thereon.....	900, 000	75, 000	240, 00
Less foreign tax credit.....	75, 000	-----	75, 00
Net tax due.....	825, 000	75, 000	165, 00

The effective rate of tax on the \$500,000 of interest income is 93 per cent (i.e. 45 per cent in country X, 15 per cent in country Y, plus 33 per cent in the United States) instead of 60 per cent due to the fact that the credits are limited to the tax imposed by the country of source (Section 6(a) of the Bill adding Section 906, House Report No. 1450 at pages 37 and 38).